



NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

AFFILIATED WITH SERVICE EMPLOYEES INTERNATIONAL UNION, AFL/CIO

1313 "L" STREET, N.W., WASHINGTON, D.C. 20005
202/371-6644

TESTIMONY OF THE

NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

TO THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

ON THE

CIVIL SERVICE PENSION REFORM ACT

S-1527

September 9, 1985

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The National Association of Government Employees which is an affiliate of the Service Employees International Union AFL-CIO is pleased to have this opportunity to present our views on S 1527, the Civil Service Pension Reform Act.

The design of a retirement system for employees covered under Social Security is a task of historical importance to the Civil Service. The Civil Service Retirement System has been government's most important tool for the recruitment and retention of quality employees. With federal pay and other benefits lagging far behind that commonly received in the private sector, it is more important than ever that the pension system available to new hire federal employees be a quality one, comparable to the current CSRS. The task facing the Congress in developing such a plan is an extremely complex one requiring mature leadership from all quarters.

The Civil Service Pension Reform Act S-1527 is an important first step towards the development of a supplemental retirement plan which will be fair to federal employees, taxpayers and consistent with the traditional goals and objectives of the Civil Service Retirement System. The Chairman is to be applauded for taking these crucial first steps towards the development of a supplemental retirement plan.

The Civil Service Pension Reform Act is structured on three

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tiers composed of Social Security, a defined benefit, or basic pension plan, and a thrift savings plan.

SOCIAL SECURITY

The first tier under S-1527 is Social Security. Employees would contribute to Social Security and receive its benefits in accordance with applicable law and regulations. Currently the tax rate for OASDI is 5.7% in 1985, increasing to 6.06% in 1988, and 6.20% beginning in 1990. Employees contribute up to the maximum taxable wage level, which currently is \$39,600. Benefits under this portion of S-1527 are determined in accordance with applicable Social Security law. While space doesn't permit documentation of that formula, it is significant to note that social security is in part a social insurance program which redistributes wealth from the high to the low income worker. Thus, for instance, under Social Security if an employee worked 30 years and earned \$15,000 annually he would receive roughly \$6,000 in benefits, while an employee earning \$30,000 annually during the same period would earn \$8200 in benefits, while an employee earning \$45,000 would receive \$8400. A basic decision in designing a pension plan is whether or not to offset the social security tilt. Stevens / Roth is a social security add on plan which does not offset social security.

DEFINED BENEFIT

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The second tier to S-1527 is the defined benefit or basic pension plan. The formula under Stevens / Roth for determining benefits would be based on 1.0 percent of the average of workers highest five consecutive years of wages for each year of service completed. By comparison the current CSRS formula is based on the high three years of salary multiplied by 1.5 times the first five years, 1.75 times years 5-10, and 2.0 for all years after 10.

Under Stevens / Roth retirement without penalty would be allowed at age 62. Employees would vest following five years in service. Employees retiring at age 55 with 30 years of service would have their benefits reduce by 2% for each year they are under the age of 62 at the time of retirement. This would constitute a 14% reduction in the annuity. Employees retiring at age 55 with less than 30 years of service would face a 5% per year reduction for every year under the age of 62. Thus an employee retiring at age 55 with 10 years of service would receive a 35% reduction in the annuity. Thus the bill provides substantial penalties for early retirement, one of the most popular features in the current system.

The bill also provides for early retirement for law enforcement officers, firefighters, and air traffic controllers after 25 years of service in the occupation. There would be no

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reduction in the annuity, and there are provisions to pay a supplemental annuity until the employee reaches age 62, and Social Security begins.

There are also provisions in the bill for an annuity at age 50 with 20 years of service and at any age with 25 years of service when an employee is involuntarily separated. These annuities would be reduced by 2% per year under the age of 62. Deferred benefits would also be payable at age 62 for workers separated with at least 5 years of service, or reduced benefits would be payable at age 55 with 10 years of service.

In the area of income protection after retirement, the Stevens / Roth bill provides substantially less protection than is provided under CSRS. Under S-1527 COLA's would be paid annually at 2 percentage points less than the rate of inflation as measured by the consumer price index. The CSRS of course allows for a full COLA adjustment based upon movement in the consumer price index.

The defined benefit plan would have no employee contributions, unlike the current system which requires a 7% contribution. Each federal agency would be required to contribute an amount equal to the normal cost of benefits for the agency's employees. The bill also requires a yearly determination of the Fund's supplemental liability amortized

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over 30 years. This contribution would come from the Treasury.

THRIFT PLAN

The third tier of the plan would create a voluntary tax deductible capital accumulation plan. Employees would be permitted to contribute up to 10% of their salaries to the plan. This contribution would be tax deductible. The first five percent of this contribution would be matched by the government. The capital accumulation plan would increase portability, and provide greater benefits to short term employees. There is currently no similar plan under CSRS.

The employee is immediately invested in his own contribution to the thrift plan. The government's contribution is vested 20% a year with total vesting occurring after five years.

The employee may elect investment of his account in government securities, fixed income securities, or equities using an index fund invested in a diversified common stock portfolio. There would be a gradual phase in of the private sector investment options.

The employee could receive a payout of the vested account balance, as an annuity, in cash at retirement, death, or disability or as a rollover to an IRA when the employee leaves

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employment. Hardship loans would be allowed to employees from their fund balance under certain limited circumstances.

SURVIVOR BENEFITS

Under Stevens / Roth the surviving spouse may get social security benefits, plus group life insurance, plus 50% of pension reduced for early retirement, and for election of joint and survivor annuity. In the instance where an individual is vested but not eligible to retire the pension to the survivor does not commence until the individual would have become eligible to retire. In addition as previously mentioned the survivor could immediately receive the thrift plan account. Under Stevens / Roth the Federal Government would assume the costs of group life insurance (FEGLI).

DISABILITY

Under Stevens / Roth a long term disability insurance plan would be administered by a third party. Employees would be eligible for disability benefits after 18 months of creditable service. If the employee was eligible for SSI he or she would receive 60% of the average high 5 salary, or 40% if not social security eligible. Benefits would be reduced by an amount equal to that received from social security. Benefits would continue until age 55 when the employee would receive an annuity in accordance with the benefit formula. Credit for

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years of service would be given during the period the employee is receiving long term disability for purposes of determining the basic pension formula.

COST

The cost of a pension plan is arguably the most important decision to be made in the shaping of a supplemental retirement plan. Under Stevens / Roth the total employer cost, according to data supplied by the Congressional Research Service, is equal to 20.8% of payroll. The defined benefit portion of the plan accounts for 11.7% of the cost, Social Security 5.9%, thrift plan 3.0%. By comparison the current Civil Service Retirement System cost is approximately 24% payroll.

ANALYSIS

The S-1527 is a comprehensive piece of legislation which addresses the many complex issues involved in the design of a supplemental retirement system. It is an important first step towards the development of a fair and workable retirement system. The design of the bill has many positive features. The bill would significantly increase the portability of pension benefits through the addition of Social Security, and a thrift plan. The large numbers of employees who contribute to CSRS and receive no benefits or return has been a problem with the System for a long time, and we're pleased to see that problem

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addressed.

We endorse now S-1527 treats the social security tilt with an add on plan rather than an offset plan. The offset plans are more complex to administer since they require a determination of social security benefits. In addition the offset plans are more difficult for employees to understand and hence make retirement planning more difficult to undertake.

The utilization in the bill of the three tier system is a design which provides maximum flexibility to the pension system. The addition of the thrift plan is an effective means of addressing the social security tilt since a tax deferred savings plan would be of particular advantage to higher paid employees since they have more cash to participate in a thrift plan, and would also receive the greatest tax benefit. A thrift plan also gives greater portability to the retirement system. However, as we will discuss later in this testimony, while we regard a thrift plan as a useful tool in the design of a supplemental pension system, the defined benefit portion is in our view the central component of that system.

We also support provisions in the bill providing for employee involvement on the Thrift Board. This is a step towards restoring credibility to the system. There has been too much distortion as to the health and stability of federal employee retirement systems which has caused widespread

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confusion and a loss of confidence in the system. Employee involvement in managing the system should aid in arresting some of these distortions.

We also agree with provisions in the bill which have the existing fund serve both the current system and the new plan on an intergrated basis. This arrangement demonstrates a committment to continue the existing Civil Service Retirement Trust Fund on a stable foundation. It is crucial that retirees under the current system be assured that the Trust Fund will continue, on a strong financial basis.

While S-1527 is an important first step towards the development of a supplemental retirement system there are substantial improvements to be made before the bill is completed. The ultimate goal from our perspective is to develop a system which overall will provide comparable levels of benefits as the current system with the same level of contributions from the employee.

We believe that in order to develop a comparable plan to the current CSRS the cost of the plan is going to have to be roughly approximate. No amount of creativity will create a plan costing 20% of payroll which will provide equivalent benfits to a plan costing 24% of payroll.

While overall Stevens / Roth is 4% less expensive than the

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current CSRS, the defined benefit costs, including Social Security, are 17.6% of payroll or some 7.4% less than the defined benefit portion of CSRS. This from our perspective is the most significant deficiency in S-1527.

Much of the savings under Stevens / Roth is achieved through the proposed changes in the COLA (3.0%), early retirement penalties (.5%), change from the high 5 to a high 3 (.9%) and changes in the defined benefits accrual rate.

In any pension plan there are winners and losers or groups of employees who fare less well than other groups of employees. Under Stevens / Roth those who can take the fullest advantage of the thrift plan, and who need the increased portability provided by the system are the winners. The losers under this bill are those who seek an early retirement after long years of service with the government, and those who are unable to take advantage of the thrift plan.

To many federal employees the promise of a dignified, secure retirement at age 55 following 30 years of service, or at age 60 with 20 years of service has been the trade off for inferior pay and benefits. For many of the employees NAGE represents early retirement after long years of hard labor is not a luxury but rather a physical necessity. Under S-1527 this course of action would involve substantially increased

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risks to the employee and his family.

It has been argued that the thrift plan will provide a means for an employee to offset the effects of the early retirement penalty by long term investment and savings through the thrift plan. Those employees who are in the most physically demanding positions and in most need of early retirement are most often in the lower grades and unable to take advantage of the thrift plan. Under S-1527 early retirement might well become an option open only to the upper grades, and closed to those most in need of the opportunity. Those who would be most likely to take advantage of the thrift plan are the upper graded employees who are in the executive and administrative ranks.

An employee retiring with 30 years of service at age 55 would replace 53% of income at all levels under the current system. Under Stevens / Roth this employee if unable to use the thrift plan would replace only 23% of pay or less than half that received under the current system. Even if this employee was able to make full usage of the thrift plan he would only replace 38% of income at all levels. At age 62 when Social Security benefits become available this employee earning \$15,000 who took full advantage of the thrift plan for 30 years would replace 57% of income, without any participation in the thrift plan only 42% would be replaced. For this same employee

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earning \$30,000, 52% would be replaced with full usage of the thrift plan, but only 37% without the thrift plan. It is highly unlikely from our perspective that employees earning \$15,000 to \$30,000 will be able to set aside 10% of their pay for their retirement.

The full COLA provision in the current CSRS provides retirees on a fixed income with some measure of protection against the long term effects of inflation. Under S-1527 this protection would be significantly diluted by providing inflation protections at the rate of CPI-2. The employee earning \$15,000 who retired at age 55 with 30 years of service would under S-1527 receive 51% of salary at age 80 with full usage of the thrift plan, without using the thrift plan this same employee would replace only 36% of income. If this same employee had earned \$30,000 the replacement rate would be 46% with the thrift plan but only 31% without using the plan.

The NAGE and its members are committed to continuing the provisions which allow for a dignified, retirement at age 55, or 60 with no penalty following long years of service. We urge the Committee to remove the penalties for early retirement, and provide full COLA protections for employees.

While we support the three tier approach conceptually we have always regarded the defined benefit portion of the plan as

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it's cornerstone. Workers need the certainty and security which a defined benefit plan provides. Defined contribution plans while allowing for greater portability, shift the risk from the employer to the employee. Retirement income thus becomes as much a factor of investment return as length of service. An over reliance on the thrift plan for providing pension income as we believe exists in S-1527, will increase the turnover in government significantly.

The thrift plan in S-1527 is unusually generous. The dollar for dollar match on the employer's contribution is higher than is generally provided in the private sector. We suggest that a 50¢ on a dollar match is more consistent with the private sector practice. This provision would save some 1.6% which should be added to the defined benefit portion of the plan.

The S-1527 relies significantly on the favorable tax treatment provided to the thrift plan. With new tax reform proposals surfacing every day, an over reliance on the favorable tax treatment of the thrift plan is a risky enterprise. If the thrift plans such as the one in S-1527 were considered taxable by the Congress than the value of the plan under S-1527 would be significantly reduced.

We urge the Committee to place a greater reliance on the defined benefits portion and less on the thrift plan as a means

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of providing retirement income. This could be accomplished by improving the retirement benefit formula, and the salary base, and by reducing the amount of the employer's matching contribution.

The thrift plan provisions as was discussed earlier especially benefit higher paid employees in two ways; one, higher paid employees will be more likely to be in a position to save the money, and, two, since the contributions will be tax deductible the higher paid employees will receive a greater benefit from the tax savings. In addition employees earning more than the social security wage base, currently \$39,000, also receive a windfall of sorts since they will pay a less percentage of income to the retirement system than other groups of federal employees. Under the terms of S-1527 new hire federal employees will pay social security taxes only up to \$39,000 with amounts in excess of that figure not taxed. By comparison employees in CSRS contribute on every dollar earned. For consistency sake the Committee might also consider requiring the full contribution for new hire employees on amounts in excess of the Social Security taxable wage base. This would generate income which could be set aside for the defined benefit portion of the plan.

The Committee might also consider maintaining parity in the contribution levels to the two retirement systems. A 1.3%

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retirement contribution, for new hires combined with the Social Security contribution would maintain parity between the old and new systems. This would also allow increased funds to be funnelled into the defined benefit portion of the plan to increase benefits.

We would urge the Committee to improve the survivor benefits under the plan. The current provisions for surviving spouses of individuals who died before retirement eligibility could cause severe financial hardship. The costs of improving this aspect of the plan would be minimal, but it provide peace of mind to all federal employees.

In conclusion S-1527 is a significant first step towards the development of a supplemental retirement plan. We congratulate the Chair for his leadership on this issue. The NAGE looks forward to working with the Chair, and the Committee in develop a supplemental retirement plan. We thank the Committee once again for this opportunity to present our views and would attempt to answer any questions.